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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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FEB 14 1997

In the Matter of)	
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Access Charge Reform)	CC Docket No. 96-262
)	
Price Cap Performance Review for Local Exchange Carriers)	CC Docket No. 94-1
)	
Transport Rate Structure and Pricing)	CC Docket No. 92-213
)	
Usage of the Public Switched Network By Information Service and Internet Access Providers)	CC Docket 96-263
)	

REPLY COMMENTS OF MCI COMMUNICATIONS CORPORATION

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Table of Contents

Summary	i
I. INTRODUCTION	1
II. THE PRO-COMPETITIVE PRESCRIPTIVE APPROACH IS SUPPORTED BY REGULATORS AND CONSUMER REPRESENTATIVES	2
III. EXCESSIVE ACCESS CHARGES SHOULD NOT BE A CORPORATE ENTITLEMENT	5
A. Any "Regulatory Compact" that May Exist Does Not Mean the Incumbent LEC Must Be Kept Whole.	5
B. Rate of Return is Still Relevant Under the LEC Price Cap.	7
IV. THERE IS NO SIGNIFICANT UNDER-DEPRECIATION OR STRANDED INVESTMENT	9
A. Universal Service Is a Transition Issue, Not a Source of Stranded Investment.	9
1. The opportunity to receive future universal service payments mitigates the need for any special recovery of assets. ...	10
2. Excess capacity does not justify special recovery of assets.	11
3. Exit obligations may apply to all carriers and do not justify special recovery of assets.	12
B. Under-depreciation Is at Best a Minimal Cause of the Gap Between Embedded Revenues and Economic Costs.	13
1. The regulatory changes initiated in the 1980s invalidates LEC arguments that regulatory policy is responsible for under-depreciation.	14
2. LECs have not met their burden of proof that depreciation lives have become shorter than those prescribed by the Commission.	16
3. LECs are not entitled to recover \$4.5 billion due to a decline in the value of their embedded plant.	19
C. Future Revenues Must Mitigate Recovery of Those Assets Determined to be Stranded.	22
D. The Commission must Rigorously Estimate All Sources of Future Revenues, Cost Savings, and Require LECs Qualifying for Recovery of Stranded Assets to Adhere to a Plan of Action Maximizing the Revenues and Cost Savings.	24
E. Increasing Depreciation Rates to Recover Legitimate Transition Costs Would Be Anticompetitive as Well as Administratively Impossible.	25

V.	SEPARATIONS AND RATE STRUCTURE ISSUES	26
A.	Misallocation of Costs Does Not Explain Excessive Access Charges.	26
B.	The TIC Should Be Eliminated, Not Renamed.	28
C.	Local Rate Increases Are Not Necessary.	29
VI.	THE ABSENCE OF A COMPETITIVE MARKET FOR ACCESS UNDERMINES THE SO-CALLED "MARKET-BASED" APPROACH . . .	31
A.	Early Indications Show Reliance on Unbundled Network Elements to Reduce Access Charges Is Misplaced.	31
VII.	PRICING FLEXIBILITY WILL ONLY FURTHER DELAY ACCESS CHARGE REDUCTIONS	35
A.	Premature Pricing Flexibility Would Preempt The Development of Competition	36
B.	The Commission's About-Face Is Unexplained	41
C.	RBOC Entry Into the InterLATA Market Should Limit Pricing Flexibility.	44
VIII.	Conclusion	45

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WASHINGTON, D.C. 20541

Summary

The pro-competitive prescriptive approach is supported by regulators, consumer advocates as well as new entrants like MCI. These parties, which are charged with bringing the benefits of competition to the end user, recognize the need for the Commission to take prescriptive steps that bring access charge reductions in the near term. Virtually all of those that filed recognized that a market-based approach will not work at this time because there is no market.

The incumbent LECs seek to create what amounts to a new telecommunications tax that would be levied on every telephone customer in an effort to keep the incumbent LEC whole. Acceptance of such a proposal would be fundamentally anti-competitive and bad public policy. MCI illustrates in its reply comments that excessive access charges should not become a corporate entitlement. Any "regulatory compact" that may exist between incumbent LECs and state and federal regulators does not mean that the incumbent LECs must be kept whole. This argument had no merit in the context of the Commission's interconnection and universal service proceedings. It is without merit in access reform as well.

MCI also rebuts in its reply comments the incumbent LECs' contention that they must be permitted to recover significant under-depreciated or stranded investment which they claim exists in their networks. The Commission has already recognized that the social goal of subsidizing local service of high cost providers has been achieved, to a great extent, through the implicit subsidies

incumbent LECs have been permitted to include in interstate access charges. Furthermore, contrary to incumbent LEC assertions, MCI demonstrates that the opportunity to receive future universal service payments mitigates the need for any special recovery of assets, excess capacity does not justify special recovery of assets, and exit obligations do not justify special recovery assets.

MCI rebuts ILEC arguments that interstate access cannot be reformed absent the conclusion of separations reform. MCI also again explains why the TIC must be eliminated, not merely renamed or reassigned as the incumbent LECs suggest. The TIC is an uneconomic, unnecessary, make-whole charge that should be eliminated. Regardless of what shape access reform ultimately takes, there is no economic basis for simply reallocating costs to various rate elements, computing the residual and renaming it a public policy element. The TIC is a tax on all users of the incumbent LEC network, including the LECs' competitors. If the Commission does not eliminate this rate element, new entrants will be forced to pay an indefensible subsidy to their new competitors. The incumbent LECs' current revenue stream, which was originally determined under regulation, should not be effectively insulated from competitive pressures.

MCI demonstrates in its reply comments why the so-called "market-based" approach proposed by the Commission will be undermined by the absence of competition in the interstate access market, and why the Commission must not afford the monopolist LECs increased, or as requested by the ILECs, unfettered pricing and regulatory flexibility, before effective competition has a

foothold in the interstate access market. The widespread concern that the market-based approach will fail to quickly reduce access charges is confirmed by attempts of MCI and other new entrants to obtain unbundled network elements and provide resale services to a local service alternative.

It comes as no surprise that the incumbent local exchange carriers are using this proceeding as an opportunity to re-argue many of the issues that have already been decided by the Federal Communications Commission in other proceedings. These arguments against the use of forward-looking economic costs and in favor of insulating the local monopoly from competitive market risks through artificially inflated access charges and other regulatory means are anti-competitive and anti-consumer. At their core, the monopolists' arguments are rooted in a clear attempt by the incumbent LECs to obtain the new competitive opportunities provided for under the Telecommunications Act of 1996 without taking any of the risks that come with a competitive marketplace. Clearly, these arguments are not valid in the new communications industry and should be rejected by the Commission.

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REPLY COMMENTS OF MCI COMMUNICATIONS CORPORATION

I. INTRODUCTION

MCI hereby submits these reply comments in the above referenced proceeding.¹ It comes as no surprise that the incumbent local exchange carriers (incumbent LECs) are using this proceeding as an opportunity to re-argue many

¹ In the Matter of Access Charge Reform, CC Docket No. 96-262; Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1; Transport Rate Structure and Pricing, CC Docket No. 91-213; Usage of the Public Switched Network by Information Service and Internet Access Providers, CC Docket No. 96-263, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, FCC 96-488, released December 24, 1996 (Notice).

of the issues that have already been decided by the Federal Communications Commission (Commission) in other proceedings.

The arguments presented, against the use of forward-looking economic costs and in favor of insulating the local monopoly from competitive market risks through artificially inflated access charges and other regulatory means, amount to a new telecommunications tax that the incumbent monopoly telephone companies want to levy on every American telephone ratepayer. Such a policy would be fundamentally anti-competitive and anti-consumer and should be flatly rejected by the Commission.

II. THE PRO-COMPETITIVE PRESCRIPTIVE APPROACH IS SUPPORTED BY REGULATORS AND CONSUMER REPRESENTATIVES

The comments by state regulators, state-appointed consumer advocates and the major consumer groups are illustrative. These are the parties that are charged with bringing the benefits of competition to the end user. Virtually all of those that filed recognized the need for the Commission to take affirmative steps to bring down access rates.

Most parties seem to agree that once meaningful competition actually exists, relying on the marketplace to deliver cost based interstate access charges is appropriate. The state regulators, who are responsible for keeping local rates just and reasonable and creating a pro-competitive environment for local service subscribe to this view. "...NARUC advocates the use of a

prescriptive approach initially, with a transition to a market-based approach gradually in those markets where and when significant actual competition evolves.”² The Texas regulators agree and added, “[a]lthough the Texas PUC strongly favors market-based solutions, we are concerned that the market-based approach as proposed in this Notice is insufficient to eliminate implicit subsidies and bring about access rates that are based on economic cost as quickly as desired.”³

This basic recognition is shared by consumer advocates. A group of state-appointed consumer advocates covering a diverse group of states said, “... the ‘market’ should not set the rates for access because of the dominant market position of the [i]ncumbent LECs.”⁴ They went on to add, “[g]iving the control to a company that still is expected to have a significant market and monopoly power is not a ‘market’ based solution.”⁵ The large membership based consumer groups echo these sentiments: “[t]he Commission’s desire to introduce market forces into the pricing of network access is laudable. It is unrealistic, however, to believe that efficient prices will be accomplished without immediate, prescriptive steps to eliminate the anti-competitive and inefficient pricing of

² NARUC Comments at 10.

³ Public Utility Commission of Texas Comments at 23-24.

⁴ See e.g., Group of State Consumer Advocates (representing California, the District of Columbia, Florida, Indiana, Iowa, Maryland, Missouri, New Jersey, Minnesota, Pennsylvania and Washington) Comments at 37.

⁵ Id.

access.”⁶

By the same token, there is widespread recognition that even with the availability of unbundled network elements, a market-based approach will not bring access charges down to economic cost, would delay the onset of meaningful local competition, and artificially enrich the incumbent LECs. For instance, even the Florida commission, which is the only state with permanent rates for unbundled network elements, said it believes “more experience would be needed to determine if unbundled network elements are actually used to create viable competitive alternatives.”⁷

The State consumer advocates address this issue as well. They maintain that reliance on the market is premature since, “[i]t is quite unclear as to the extent to which this competition will actually occur and the degree to which competitive pressures will constrain LEC rates.”⁸ They go on to add that “[c]ompetition from unbundled network elements will not specifically constrain interstate switched access rates.”⁹

At their core, the monopolists’ arguments are rooted in a clear attempt by the incumbent LECs to obtain the new competitive opportunities provided for

⁶ American Association of Retired Persons, Consumer Federation of America and Consumers Union Comments at 7.

⁷ Florida Public Service Commission Comments at 7.

⁸ State Advocates Comments at 38.

⁹ Id. at 39.

under the Telecommunications Act of 1996¹⁰ without taking any of the risks that come with a competitive marketplace. Clearly, these arguments are not valid in the new communications industry and should be rejected by the Commission.

III. EXCESSIVE ACCESS CHARGES SHOULD NOT BE A CORPORATE ENTITLEMENT

A. Any “Regulatory Compact” that May Exist Does Not Mean the Incumbent LEC Must Be Kept Whole.

The incumbent LECs are making the same baseless, failed arguments about cost based pricing being an unconstitutional taking of property in this proceeding as they have made elsewhere. Just as it was incorrect in the context of the interconnection¹¹ and universal service¹² proceedings, it is incorrect for access reform as well. In this proceeding, the companies stress the concept of a so-called regulatory compact between the company and state and federal regulators.¹³ To the extent that such a “compact” exists, it must be reviewed in

¹⁰ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996 Act), to be codified at 47 U.S.C. §§ 151 et. seq.

¹¹ Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, CC Docket No. 96-98, 11 FCC Rcd 15499 (1996). (Interconnection Order)

¹² In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Recommended Decision, FCC 96J-3 (rel. Nov. 8, 1996). (Joint Board Recommendation)

¹³ See e.g., Southwestern Bell Comments at 40, (“The efficiency of LEC operations must be reviewed in light of the regulatory social contract

the context of the massive earnings of the incumbent LECs while they have been protected from all of the risks of the competitive market.

The incumbent LECs want it both ways. On the one hand, the incumbent LECs want the Commission to find that any system which does not guarantee recovery of historic, embedded costs is, by definition, an unconstitutional taking.¹⁴ On the other hand, the companies also imply that because of the imposition of price cap regulation, it is inappropriate for the Commission to look at the companies' rates of return. Neither claim is correct.

MCI's initial comments included a takings analysis which clearly demonstrates that the law requires a regulator to look at the overall ability of the company to earn a reasonable profit and attract investors when regulatory changes are made.¹⁵ Specifically, courts have found that utilities have no right to a particular overall level of return. The court in Federal Power Commission v.

under which the LECs operate. The prudence of LEC costs incurred to meet these unique public service obligations has already been proven."); GTE Comments at 80-81, ("Whether a taking has occurred depends on whether the utility had an opportunity to earn a fair rate of return on its prudent investment. This regulatory contract permitted government to limit the utility's rate of return, in exchange for insulating the public utility from most market risks."); Pacific Telesis Comments at 44-45, ("In addition, the failure to allow recovery of all embedded costs would amount to an unconstitutional taking of ILECs' property without just compensation and break the long-standing 'regulatory bargain' between incumbent local exchange carriers and the Commission.

¹⁴ Id.

¹⁵ See MCI Comments at 28.

Hope Natural Gas Co.,¹⁶ said the mere “fact that the value of the [utilities property] is reduced does not mean that the [rate] regulation is invalid.”¹⁷ In the case of the incumbent LECs, where the facilities at issue will eventually be used to provide competitive services including long distance, a credible case simply cannot be made that there is an unconstitutional taking.¹⁸

Of equal importance in this context, where it is clear that the correct public policy is to have the Commission drive access charges down to their forward-looking economic cost, is the position of the court in Duquesne Light Co. V. Barasch.¹⁹ That court approved of a rate making methodology that “mimics the operation of a competitive market” and “gives utilities strong incentives to manage their affairs well and to provide efficient services to the public.”²⁰ This is the essence of the forward-looking costing model adopted by the Commission previously and endorsed by the Federal-State Joint Board on Universal Service.

B. Rate of Return is Still Relevant Under the LEC Price Cap.

The notion that the imposition of the LEC price cap means that the Commission would no longer look at the rate of return of the incumbent LECs is

¹⁶ 320 U.S. 591, 602 (1944).

¹⁷ Id. at 601.

¹⁸ The fact that the incumbent LEC holds the keys to access to new markets, including entry into long distance, and the new revenue opportunities they represent should be noted.

¹⁹ 488 U.S. 199 (1989).

²⁰ Id. at 308-09.

absolutely wrong. The price cap includes a sharing mechanism which provided that once earning reached a specified level, part and eventually all of the excess profits had to be shared with the users.²¹ The LEC price cap also included a plan to revisit the cap periodically and make any necessary readjustments to reflect increased productivity or to reinitialize the cap necessitating a review of the earnings of the incumbent LECs.²²

The fact is, the incumbent LECs are trying desperately to keep the Commission from reviewing and considering their revenues for purposes of reforming access charges. The reason is, the incumbent LECs are well aware that they cannot demonstrate an unconstitutional taking because of their high level of earnings and the new revenue opportunities provided under the 1996 Act.

As MCI stated in its initial comments, if the incumbent LEC wants to claim a taking, the Commission must review the actual earnings of the regulated companies over time and take into consideration any earnings above the 11.25 percent allowable rate of return as a potential offset to any claimed

²¹ Policy and Rules Concerning Rates for Dominant Carriers (Price Cap Order), CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786 (1990) at para. 389. (Price Cap Order) Bell Atlantic/NYNEX point out that the Commission has indicated the elimination of sharing as a long term goal. Such a step would only be appropriate, however, once access rates were brought down to competitive market levels either by the Commission or by vigorous competition, which is certainly not the case today. Bell Atlantic/NYNEX Comments at 25.

²² Id.

uncompensated investment. MCI believes the incumbent LECs have either already been well compensated for their investments and potential risk and, nonetheless, will have an opportunity to recover in the competitive marketplace all of its legitimate investments.

IV. THERE IS NO SIGNIFICANT UNDER-DEPRECIATION OR STRANDED INVESTMENT

A. Universal Service Is a Transition Issue, Not a Source of Stranded Investment.

In its Notice, the Commission sought comment on issues pertaining to the "...transition from the regulatory structure that existed before the passage of the 1996 Act to that which will exist after the three proceedings (interconnection, universal service, and access reform) have been completed."²³

The Commission recognized that the social goal of subsidizing local service of high cost providers has been achieved, to a great extent, through the implicit subsidies incumbent LECs have been permitted to include in interstate access charges. The expectation of local competition following the passage of the 1996 Act as well as provisions in the Act itself, requires the Commission to reconstitute these subsidies on an explicit basis since: a) implicit subsidies give incumbents a competitive advantage by making them the sole recipients of

²³ Notice at para. 251.

subsidies; and b) jeopardize the stability of the subsidy source, since new access providers are not required to contribute to this implicit universal service funding.²⁴

The Commission proposed removing these subsidies from access rates through an annual exogenous adjustment to the CCL charge.²⁵ This exogenous adjustment was viewed as being necessary to prevent the double recovery of universal service obligations of incumbent LECs. The Commission's proposed exogenous adjustment was linked to an incumbent LEC's prior reception of universal support from an explicit subsidy fund. The Commission did not link universal service with the recovery of particular assets owned by the LECs.

1. The opportunity to receive future universal service payments mitigates the need for any special recovery of assets.

MCI considers this absence of linkage between universal service support and recovery of particular LEC assets an important point. Incumbent LECs imply that their universal service obligations have required them to make investments they otherwise would not have made, implying that they would be left with stranded assets unless they are entitled to recover all of their embedded costs throughout their network, now and forevermore.

"The utility's investors would not be willing to commit vast amounts of capital to carry out an obligation to serve unless the regulator's

²⁴ 1996 Act at §254(b)(4). ("[A]ll providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service.")

²⁵ Notice at para. 245.

offer of an opportunity to earn a fair rate of return was credible. Regulated utilities relied upon those contractual assurances in planning..."²⁶

This argument does not have merit. Risks associated with incumbent LEC investments in high cost areas have long been mitigated by various universal service payments, precisely so that their investments in these areas would have the same opportunity to earn a fair return as investments made to serve other parts of their networks, or investments made by other LECs. As long as incumbent LECs continue to have the opportunity to receive universal service funding for these high cost areas, they continue to have their risk reduced. Incumbent LECs therefore have no right to consider these assets to be stranded.

2. Excess capacity does not justify special recovery of assets.

Incumbent LECs attempt to parlay the legitimate concern surrounding obligations to serve high cost areas to a general commitment to recover the embedded costs of all their network investments. They imply that all excess capacity is intended to serve peak demand,²⁷ and large customers returning from a competitors' service.

"...a customer may contract with an entering carrier offering resale services or services that are provided using some combination of the incumbent's unbundled network elements and the entrant's facilities. Nonetheless...the utility must maintain sufficient capacity

²⁶ USTA Comments, CC Docket No. 96-262, Attachment 3, Affidavit of J. Gregory Sidak and Daniel F. Spulber at 45. (Sidak Affidavit)

²⁷ Sidak Affidavit at 57.

to serve the departed customer *if it returns*.”²⁸

This argument does not withstand scrutiny. Incumbent LECs may not recover investments that are not used or useful unless they can show that this excess capacity was specifically installed to serve departing customers they had an obligation to serve. Such a showing shall be made in a special proceeding, on a case-by-case basis. It is highly unlikely that the tremendous amount of excess capacity that has been present for years was made to serve large customers that may, or may not, return years into the future.

In addition, it is highly unlikely that the return of such a large customer would pose any over-capacity problem for the LEC, since for the near future that customer will be served primarily by new entrants using resale and unbundled network strategies. Return of large customers will only be an issue once new entrants offer service primarily over their own facilities. By that time LECs will have been given sufficient time to adjust their investments to the demand conditions of the more competitive environment. And, by that time, facilities-based entrants will face the same risk of stranded investment upon the loss, and potential return, of a large customer.

3. Exit obligations may apply to all carriers and do not justify special recovery of assets.

Finally, USTA argues that incumbent LECs are entitled to special recovery

²⁸

Sidak Affidavit at 59.

of their embedded assets because

“...a utility must secure the regulator’s authorization through an abandonment proceeding to withdraw service. Unlike the utility, competitive entrants can abandon any of their facilities at will. The prohibition on abandonment is therefore clearly an incumbent burden.”²⁹

Although not factually correct, this argument sheds light on the fact that the incumbent LECs have a fundamental lack of understanding of the competitive marketplace. They seem to see the greater risk of losses faced by new entrants as an advantage! Since Section 214(e)(3) the 1996 Act permits multiple companies to be carriers-of-last-resort, both new entrants and incumbent LECs may be required to apply for permission from regulators to exit a particular market. In any event, the 1996 Act places equal risk of suffering financial loss on new entrants and incumbents alike.

**B. Under-depreciation Is at Best a Minimal Cause of the Gap
Between Embedded Revenues and Economic Costs.**

The second transition issue the Commission identifies is treatment of the “gap” between embedded interstate access revenues and the revenues that would be produced if access charges were brought to their forward-looking cost. The Commission identified under-depreciation of incumbent LEC assets as one possible cause of the difference between embedded revenues and forward looking costs. LECs argue that regulatory policies have resulted in an under-

²⁹ Sidak Affidavit at 60.

depreciation of their assets. They argue that: a) existing depreciation procedures do not recognize the decline in the economic value of plant that occurs when replacement cost is less than the cost of existing plant; and b) existing Commission-prescribed depreciation lives are longer than the economic lives of their assets.

1. The regulatory changes initiated in the 1980s invalidates LEC arguments that regulatory policy is responsible for under-depreciation.

The depreciation changes put in place by the Commission in 1988,³⁰ the adoption of its Joint Cost Rules in 1987,³¹ and price cap regulation in 1990,³² constitute a new system of regulation that invalidates LEC claims that regulatory policy is responsible for under-depreciation. These regulatory changes were premised on the belief that investors would bear greater investment risk in exchange for the opportunity to earn increased profits for shareholders.

In the early 1980s the Commission altered its depreciation procedures

³⁰ See Amendment of Part 31 (Uniform System of Accounts for Class A and Class B Telephone Companies), 83 FCC 2d 267 (1980) (Property Depreciation), Order on Reconsideration, 87 FCC 2d 916 (1981), Supplemental Opinion and Order, 87 FCC 2d 1112 (1981), and Amortization of Depreciation Reserve Imbalances of Local Exchange Carriers, Report and Order, (Amortization of Depreciation Reserve Imbalances Order) 3 FCC Rcd 984 (1988).

³¹ Separation of costs of regulated telephone service from costs of nonregulated activities (Jt. Cost Recon Order), CC Docket No. 86-111, Order on Reconsideration, 2 FCC Rcd 6283 (1987).

³² Price Cap Order.

from whole life depreciation to remaining life depreciation. At that time, the Commission also amortized the then existing shortfall so that historical policies are hardly reflected in the current rate base, if reflected at all. It took this action in recognition that whole life depreciation created a tendency toward insufficient depreciation. Remaining life depreciation minimized the risk that a carrier would suffer a depreciation shortfall due to the life of an asset becoming shorter, by permitting carriers to increase depreciation expense in response to asset life reduction.³³

The Commission's Joint Cost Rules were adopted with the intent of encouraging incumbent LECs to undertake investment in facilities that could be used to offer both regulated and unregulated services.³⁴ In that proceeding and its subsequent Reconsideration Order, the Commission adopted some key policies that made LEC entry into nonregulated services less risky and more financially profitable. First, the Commission determined that LECs would be able to use facilities to jointly offer regulated and nonregulated services, thereby permitting nonregulated services to benefit from economies of scope. Second, the Commission determined that it was not necessary to regulate the prices of

³³ See Property Depreciation Order on Reconsideration, and Amortization of Depreciation Reserve Imbalances Order.

³⁴ The Commission viewed its Joint Cost rules as being "suitable for an increasingly competitive telecommunications environment..." Separation of costs of regulated telephone service from costs of nonregulated activities, Report and Order, (Joint Cost Order) CC Docket No. 86-111, 2 FCC Rcd 1298 (1987) at para. 40.

nonregulated services, regardless of the competitive structure of those industries. Finally, the Commission decided to allocate joint and common asset costs to nonregulated activities in accordance with three year forecast demand, rather than the demand expected over the life of the asset, thereby shifting more of the risk of unsuccessful nonregulated activities onto LEC shareholders.

Price cap regulation, and incentive regulation generally, permitted incumbent LECs to retain a portion of net revenues in excess of their fair rate of return, in exchange for investors sharing the risk of earning below their fair rate of return. In 1995 the Commission offered price cap LECs the opportunity to retain all revenues in excess of their fair rate of return in exchange for meeting a higher productivity factor.

These regulatory changes were intended to serve as a transition to competition. As a result of this system, incumbent LECs have had sufficient opportunity to make investments, market services, implement faster replacement of their plant and equipment, propose and win approval for higher rates of depreciation, and reduce the value of their regulated assets providing telephone service. This new regulatory system has laid the foundation for nearly complete mitigation of any assets being included in a transition fund associated with the 1996 Act.

2. LECs have not met their burden of proof that depreciation lives have become shorter than those prescribed by the Commission.

The depreciation lives currently established by the FCC are based on

"statistical studies of the most recently prescribed factors. These statistical studies required detailed analysis of each carrier's most recent retirement patterns, the carriers' plans, and the current technological developments and trends."³⁵ Comparison of LEC accrual rates to retirement rates confirm that current FCC depreciation prescription rates have already accounted for accelerating technological development.

LEC accrual rates in 1995 were 7.1 percent. At the same time their retirement rate was 3.5 percent. "The prescription of an accrual rate much higher than the current retirement rate indicates an expectation that the retirement rate will be much higher in the future. If the FCC were prescribing depreciation rates based upon historical indicators, it would be prescribing depreciation rates in the range of 3 to 5 percent."³⁶

USTA argues in this proceeding that remaining lives of network assets are shorter than lives permitted by the FCC in its current depreciation prescription rates, amounting to a depreciation shortfall of \$39 billion.³⁷ They maintain that shorter depreciation lives are justified because the RBOCs have chosen to use

³⁵ Report on Telephone Industry Depreciation, Tax and Capital/Expense Policy, Accounting and Audits Division, FCC, April 15, 1987 (AAD Report) at 3.

³⁶ Direct Testimony of Michael Majoros, on behalf of AT&T and MCI, Before the Ohio Public Utilities Commission, Case No. 96-922-TP-UNC, at 7.

³⁷ See USTA Comments, Implications of Technology Change and Competition on the Local Exchange Carriers; Adrian J. Poitras, Lawrence K. Vanston, Technology Futures, Inc. at 7. (TFI Report)

faster depreciation lives established by the Financial Accounting Standards Board (FASB) for financial reporting purposes than have been permitted by the FCC.³⁸

It would not be appropriate to use depreciation lives established by FASB for financial accounting purposes for regulatory purposes unless rates of return were substantially reduced at the same time. Adopting shorter depreciation lives virtually guarantees that remaining asset values will be recovered. FASB's depreciation policy is premised on the goal of reducing the risk to financial investors. It would be inappropriate to apply this policy goal of reducing risk to the regulatory assets of the LECs. Doing so would shift all of the burden of bearing any risk on today's ratepayers, without any assurance that future ratepayers would receive any benefits from this risk reduction. It would contradict the premises of the current regulatory policies, namely granting incumbent LECs increased earnings opportunities in exchange for them bearing greater amounts of risk.

LECs also argue that the FCC should reduce their depreciation lives since plant lives used by interexchange carriers (IXCs) and cable companies are shorter than the depreciation lives permitted them by the FCC.³⁹ Neither industry is appropriate to use as a benchmark for determining depreciation lives. At the

³⁸ Id. at 6.

³⁹ Id. at 8.

moment, IXCs and cable companies have not yet established a facilities-based local exchange presence. Consequently, it would be completely inappropriate to reconsider depreciation lives for LEC assets on this basis.

3. LECs are not entitled to recover \$4.5 billion due to a decline in the value of their embedded plant.

LECs advocate being compensated \$4.5 billion from a decline in the economic value of their plant due to the availability of cheaper technologies.

They argue that:

"[o]nce a market is effectively competitive, a LEC will be able to recover...only the economic value of the capital...At that time, it will be too late for regulators to solve the problem by granting price increases on competitive services, because prices will be limited by market forces."⁴⁰

Incumbent LECs admit that it is possible to build a telephone network today much cheaper than the embedded value of their current network, simply by utilizing the most efficient technologies currently available.⁴¹ What they don't

⁴⁰ USTA Comments, Attachment 15, "The Depreciation Shortfall," Jeffrey H. Rohlfs, Charles L. Jackson, and Ross M. Richardson, Strategic Policy Research at 12. (SPR Report)

⁴¹ "CO switch prices have dropped steadily....switch prices will decline by slightly more than 20 percent over five years." (SPR Report at 13)

New entrants to the switch manufacturing business...drastically reducing the start-up and operating costs of voice response services..." (SPR Report at 15)

"...the benefits of these technologies (fiber in the loop, asynchronous transfer mode switching, synchronous optical network, and time division multiple access) are reduced operating costs, reduced capital costs..." (TFI Report at 3)